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FM AMEMBASSY CARACAS
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RUEHAC/AMEMBASSY ASUNCION 0968
RUEHBO/AMEMBASSY BOGOTA 7947
RUEHBR/AMEMBASSY BRASILIA 6109
RUEHLP/AMEMBASSY LA PAZ 2860
RUEHPE/AMEMBASSY LIMA 1142
RUEHSP/AMEMBASSY PORT OF SPAIN 3667
RUEHQT/AMEMBASSY QUITO 2956
RUEHSG/AMEMBASSY SANTIAGO 4087
RUEHDG/AMEMBASSY SANTO DOMINGO 0615
RHEHNSC/NSC WASHDC
RHEHAAA/WHITEHOUSE WASHDC
RHEBAAA/DEPT OF ENERGY
RUCPDOC/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
RUMIAAA/HQ USSOUTHCOM MIAMI FL

C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 000282

SIPDIS

ENERGY FOR CDAY AND ALOCKWOOD, DOE/EIA FOR MCLINE
HQ SOUTHCOM ALSO FOR POLAD
TREASURY FOR RJARPE
COMMERCE FOR 4431/MAC/WH/JLAO

E.O. 12958: DECL: 01/29/2019
TAGS: EPET EINV ENRG ECON VE
SUBJECT: VENEZUELA: CONFLUENCE OF CHAVEZ AND OBAMA OIL
POLICIES?

REF: A. (A) 08 CARACAS 0366
¶B. (B) 08 CARACAS 1341
¶C. (C) 08 CARACAS 1428
¶D. (D) 08 CARACAS 1540
¶E. (E) CARACAS 87
¶F. (F) CARACAS 104
¶G. (G) CARACAS 106
¶H. (H) CARACAS 136
¶I. (I) CARACAS 239

Classified By: Economic Counselor Darnall Steuart, for reasons 1.4 (b) and (d).

¶1. (C) SUMMARY: Press reports have picked up on DOE/EIA statistics indicating that Venezuelan exports to the U.S. decreased 12.3% in 2008 and have concluded that President Chavez's plans to reduce oil exports to the U.S. are succeeding. The stories ignore the broader impact of the last ten years under President Chavez, i.e., increased domestic consumption and decreased production of nearly one million b/d compounded by the twin losses of management experience at PDVSA and foreign investment in the oil sector. Current low oil prices are pulling back the curtain on PDVSA revealing a company with serious financial and operational problems. Decreased quantities of oil available for export will present the GBRV with a choice between advancing its political agenda (i.e., diversifying away from the U.S.) or its economic agenda (i.e., securing market prices for oil to maintain domestic spending). In the current economic environment, it will be difficult for PDVSA to attract foreign investment to offset declination in its oil fields, much less to increase production. Stubbornly low oil prices will bring about an economic day of reckoning for Venezuela, but the question remains when it will come and what will be the spark that sets it off. END SUMMARY.

¶2. (C) Local press reports have picked up on DOE/EIA statistics indicating that Venezuelan exports to the U.S. decreased 12.3% in 2008 and have concluded that President Chavez's plans to reduce oil exports to the U.S. are

succeeding. They have also started contemplating the future of the Venezuelan economy in response to President Obama's stated goal of ending U.S. dependence on Middle Eastern and Venezuelan oil. OPEC and IEA estimate Venezuela's 2008 production fell short of 2.2 million b/d (Venezuela produced more than 3 million b/d in 2000). DOE/EIA figures for 2009 show exports to the U.S. barely over one million b/d - down from a high of 1.554 million b/d in 2004 (Note: Exports to the U.S. peaked at 1.773 million b/d in 1997, two years before Chavez came to power). This selective blindness ignores the impact of the last ten years under President Chavez, i.e., decreased production and increased domestic consumption compounded by lost foreign investment in the oil sector.

¶3. (C) With production at 2.2 million b/d, exports to the U.S. hovering around one million b/d and domestic consumption around 800,000 b/d, Venezuela has roughly 400,000 b/d available for other export markets. In order to increase exports to China, PetroCaribe participants or Cuba, Venezuela must increase production, decrease domestic consumption, or continue to shift exports away from the U.S.

PRODUCTION PROBLEMS

¶4. (C) Years of lost investment also continue to take a toll on Venezuelan production. Industry analysts have long estimated that PDVSA must spend at least $3 billion each year just to maintain production levels at existing fields, as many of the fields suffer annual decline rates of at least 25

percent. In order for PDVSA to increase production, it needs investment that supersedes declination. Industry experts continue to question whether the company that emerged from the December 2002-February 2003 oil strike has the technical capabilities to absorb the needed annual capital investment (Note: The government fired nearly 20,000 managers and workers which represented nearly half of PDVDA's work force. Since then, there have been constant accusations of increased politicization of all levels within the organization.).

¶5. (C) Compounding production problems and stoking greater domestic problems is Venezuela's natural gas shortage. Despite healthy reserves of natural gas, Venezuela is importing natural gas from Colombia. PDVSA,s attempts to get off-shore natural gas development underway have been slow and its development program in the eastern Anaco gas production area also seems to be experiencing critical challenges. Failure to develop natural gas undermines oil field maintenance because when gas is reinjected into oil fields, it helps maintain production levels. The impact of domestic shortages is exacerbated by its every day role in the lives of over 88 percent of Venezuelans who use gas for cooking and other needs.

¶6. (C) PDVSA also continues to struggle with operational problems at its refineries and in the production fields. The lack of investment on maintenance, equipment, shortages of skilled staff, and supervisory skills has led to an increased number of unplanned shutdowns and affects production.

FINANCIAL PROBLEMS

¶7. (C) Transfers from PDVSA to Chavez's social programs (missiones) to finance social spending have taken a toll on the company and introduced severe liquidity problems. PDVSA currently needs to settle several billion dollars in outstanding service company bills as well as overdue dividend payments to international oil company operators. Venezuela's crude basket price peaked in July 2008 at $129.54/barrel. Thus, PDVSA's liquidity problems began before oil prices started falling to an average of $36/barrel in 2009.

¶8. (C) According to Yasuyuki Ozaki, Director of Project Development for Mitsubishi (strictly protect throughout), 80%

of PDVSA's 2009 investment budget of $11 billion has been designated for Exploration and Production (E&P) activities. Of that $11 billion, he said, $4 billion is expected to come from external sources. However, given current financial market conditions and the experience of the international oil companies in migrating their investments to joint ventures with PDVSA control, it is hard to imagine that PDVSA will have an easy time of raising additional investment capital.

CARABOBO ROUND

¶9. (C) Venezuela has increasingly staked its production future on the development of its extra heavy crude. The seven blocks in the Carabobo Round could eventually produce over 800,000 b/d of upgraded crude oil. Industry experts, however, continue to question the economics of these projects in the current environment of low oil prices and difficulties in obtaining international financing, especially when the costs could be as high as $20 billion.

COMMENT

¶10. (C) Venezuela's production continues a steady downward trend. Declines in production may well be compounded by increased foreign export commitments that support the

Bolivarian Revolution but lower the amount of oil sold at market prices, forcing the GBRV to make hard political and economic choices. A decade of lost foreign investment and production has put a premium on developing new fields (i.e. Carabobo), but the impact of long-lead times on these projects, lack of current liquidity to finance them, and current low oil prices makes it even likelier that the time lines will slip and PDVSA will not see significant new production before 2015. New production in Carabobo will not, however, offset the nearly one million b/d in lost production since Chavez assumed power.

¶11. (C) The danger of a Venezuelan economic model predicated on ever-rising oil prices is clear: should oil prices stabilize or fall (as they have), at some point the BRV would be forced to stop the growth in imports and government spending, and the economy would begin to contract. As Post has consistently argued, this economic model is unsustainable and could lead to an economic crisis such as a significant devaluation and/or recession in a timeframe largely determined by oil prices. END COMMENT.

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